Editor's note: appealed - dismissed sub nom. Supron Energy Corp. v. Hodel, Civ.No. 80-0463 JB (D.N.M. 1990), Conoco, Inc. v. Hodel, Civ.No. 80-0261C (D.N.M. 1990), Exxon Corp. USA v. Hodel, Civ. No. 80-430 JB (D.N.M. 1990); dismissal due to Jicarilla Apache Tribe v. Supron Energy, 728 F.2d 1555 (10th Cir. 1984), on rehearing 782 F.2d 855 (1986), modified by 793 F.2d 1171 (1986), cert denied 479 US 970 (1986)

SUPRON ENERGY CORP. ET AL.

IBLA 79-374, etc. Decided March 21, 1980

Consolidated appeals from decisions of the Acting Deputy Commissioner, Indian Affairs, IND-9, 10, 13, 14, 15, and 16-O&G, affirming decisions of the Geological Survey's Area Oil and Gas Supervisor, Albuquerque, New Mexico, establishing values for determining royalty on Jicarilla Apache tribal oil and gas leases and requiring initiation of a dual accounting system.

Affirmed in part; remanded in part for further documentation.

1. Accounts: Generally -- Geological Survey -- Indian Lands: Leases and Permits: Oil and Gas -- Indian Lands: Oil and Gas Leasing: Generally -- Oil and Gas Leases: Royalties

A Geological Survey Area Supervisor is acting within the authority granted to him by applicable provisions of Indian oil and gas leases and Indian and Federal royalty regulations when he decides to adopt the greater of either 1) actual sales prices of production from the leased lands or 2) a substitute price computed by him which is reasonably based on sales prices from all production from other similar tribal leases in the area, as the "value" of gas produced on these leases, and when he directs lessees to compute royalty based on the greater of the two values so calculated.

2. Accounts: Generally -- Geological Survey -- Indian Lands: Leases and Permits: Oil and Gas -- Indian Lands: Oil and Gas Leasing: Generally -- Oil and Gas Leases: Royalties

Where the Area Supervisor assembles data concerning sales from all Jicarilla tribal leases for a particular year and determines the median sales price, his use of this figure as a minimum floor price by which to determine value will be affirmed, as this decision is within the latitude afforded him, and this price is reasonably based on transactions indicative of the actual value of the production in the area at that time.

3. Accounts: Generally -- Geological Survey -- Indian Lands: Leases and Permits: Oil and Gas -- Indian Lands: Oil and Gas Leasing: Generally -- Oil and Gas Leases: Royalties

A lessee's obligation to pay royalty based on an accurate determination of the current value of production is not mitigated by its having committed by long-term contract to sell this product at a price below this value.

4. Accounts: Generally -- Geological Survey -- Indian Lands: Leases and Permits: Oil and Gas -- Indian Lands: Oil and Gas Leasing: Generally -- Laches -- Oil and Gas Leases: Royalties -- Payments: Generally

Where Geological Survey did not expressly state otherwise, under its policy established and in effect since 1958, royalty payments are accepted subject to post audit and correction and do not necessarily constitute payments in full of royalty obligations. The Area Supervisor's silence does not imply acceptance; nor does his inaction bar the Government from asserting the incorrectness of the payment subsequently.

5. Accounts: Generally -- Geological Survey -- Indian Lands: Leases and Permits: Oil and Gas -- Indian Lands: Oil and Gas Leasing: Generally -- Oil and Gas Leases: Royalties

The Area Supervisor has the authority to require a lessee to determine the value of the lease product by both the "BTU" and "net-realization" methods and may require the lessee to adopt as value whichever result is higher as the basis for computation of royalty for natural gas.

6. Accounts: Generally -- Courts -- Geological Survey -- Indian Lands: Leases and Permits: Oil and Gas -- Indian Lands: Oil and Gas Leasing: Generally -- Oil and Gas Leases: Royalties -- Res Judicata

   Where a United States district court has ordered a lessee to adopt a dual accounting method of determining value and has ordered the Department to require this dual accounting from the lessee, the question of the propriety of the Area Supervisor's order doing so is apparently res judicata, the only question being whether the order is the court's final action.

7. Accounts: Generally -- Geological Survey -- Indian Lands: Leases and Permits: Oil and Gas -- Indian Lands: Oil and Gas Leasing: Generally -- Oil and Gas Leases: Royalties

   Under controlling provisions, an Area Supervisor has the discretion to establish a cost-of-manufacture allowance for use in the net-realization method of determining value for royalty purposes. Where this allowance is well based on the actual amounts needed to process out by-products of the crude gas, it will be upheld in the absence of a clear showing that it is erroneous.

APPEARANCES: Bruce D. Black, Esq., and William S. Jameson, Esq., Sante Fe, New Mexico, for Supron Energy Corp.; Don Crestman, Esq., Fort Worth, Texas, for Southland Royalty Co.; Robert Rosnick, Esq., Denver, Colorado, for Consolidated Oil and Gas Co.; Harold L. Hensley, Jr., Esq., Roswell, New Mexico, for Exxon Co., U.S.A.; Jason Kellahin, Esq., Santa Fe, New Mexico, for Atlantic Richfield Co., Continental Oil Co., and Tenneco Oil Co.; Robert J. Nordhaus, Esq., Albuquerque, New Mexico, for amicus curiae Jicarilla Apache Tribe; William R. Murray, Jr., Esq., Office of the Solicitor, for the Deputy Commissioner, Indian Affairs.

OPINION BY ADMINISTRATIVE JUDGE STUEBING

Supron Energy Corp. (Supron) and each of the other appellants (lessees), holders of Jicarilla tribal oil and gas leases producing large volumes of natural gas and related products, have appealed from decisions by the Acting Deputy Commissioner, Indian Affairs (the Deputy Commissioner), issued between December 1978 and March 1979. 1/

1/ See appendix.

Owing to the similarity of the subject matter presented in these appeals, we have consolidated them for consideration.

At various times on and after December 9, 1976, 2/ the Area Oil and Gas Supervisor (Area Supervisor), Albuquerque, New Mexico, of the Geological Survey (GS), issued letter orders to lessees directing them to recompute royalties due on all Jicarilla tribal leases for the years 1971 through 1973 on the basis of specified minimum prices for each thousand cubic feet (mcf) of natural gas produced from them. As GS has subsequently explained, these minimum prices were to preempt any lower sale prices actually reported on any monthly reports of sales during this 3-year period, but were not to replace any higher prices on these reports. Thus, the Area Supervisor established floor prices for gas produced from these leases. The enunciated basis for his decision was that a detailed review of the gas pricing on all Jicarilla tribal leases for these years disclosed that the major portion of gas from these leases was sold at prices equal to or higher than the amounts specified as minimums for these years. Finally, lessees were ordered to remit any additional royalties due under this method.

Lessees appealed the Area Supervisor's orders to the Director, GS, and the Commissioner of Indian Affairs, pursuant to 30 CFR 221.66 and Part 290. Between December 20, 1978, and March 8, 1979, the Deputy Commissioner issued six decisions disposing of these appeals, in which he affirmed the Area Supervisor's orders establishing minimum prices as they affected all of the lessees. 3/ Lessees appealed these decisions to this Board, challenging the imposition of minimum floor prices for gas by which to redetermine royalty.

On December 10, 1976, the Area Supervisor issued an order directing Supron to initiate computation of value under both the "BTU" ("British Thermal Unit") and "net-realization" methods for the years 1974 through 1976 and to redetermine royalty based on the method yielding the higher value. Additionally, the Area Supervisor specified amounts to be used by Supron as cost-of-manufacture allowances under the net-realization method for each of these years. On December 13, 1976, the Area Supervisor ordered Supron to adopt the minimum floor prices discussed above. Supron appealed both of these orders.

In the decision concerning Supron's appeal (IND-10-O&G), the Deputy Commissioner held that the Area Supervisor's order establishing floor prices was correct, but he remanded the matter to the Area Supervisor for further documentation concerning the order which directed Supron to adopt the "BTU" and "net-realization" methods.

2/ See appendix.
3/ See appendix.

Specifically, the Deputy Commissioner noted that the records failed to show the elements of cost of manufacture used to determine the allowance specified in this order. Accordingly, he directed the Area Supervisor to explain to Supron how he had computed these allowances and why he did not adopt two-thirds of the value of the marketable products as the cost of manufacture, as provided in 25 CFR 171.13(a).

The Jicarilla Apache Tribe, as lessor of the subject leases attempted to intervene in the proceeding before the Deputy Commissioner to review the Area Supervisor's decisions, but its request was denied. The tribe also moved this Board for leave to appear in these appeals, but only as amicus curiae, and we granted this motion on July 9, 1979. However, we note that almost certainly we would have granted the tribe's full status to intervene as a party, had it so moved, in light of its direct interest in the resolution of these appeals.

We note initially that the "administrative records" submitted to this Board by GS in connection with these appeals are grossly incomplete. For example, they do not contain copies of the Area Supervisor's letter orders, from which the appeals directly followed. But for the inclusion of copies of these orders by lessees, we would have no idea when the orders were issued or what their contents were. The files contain no information prior to the filing of appeals by the lessees from the Area Director's decisions. Again, but for the diligence of the Solicitor in assembling the facts on which the Area Supervisor based these orders, we would have no basis on which to review their correctness. Finally, they do not contain several of the notices of appeal to this Board which lessees apparently filed with the Deputy Commissioner.

[1] The first issue here, which affects all lessees, is whether the Area Supervisor had authority to specify minimum floor prices for gas produced on these leases for the purpose of determining value and, if so, whether his determination of these values were correct. The regulation, 25 CFR 171.13(a), grants the Area Supervisor broad power in determining the value of oil and gas produced from leases on which royalty is calculated:

> § 171.13 Rates of rentals and royalties under oil and gas leases.
>
> (a) The lessee shall pay, beginning with the date of approval of oil and gas leases by the Secretary of the Interior, * * * during the continuance, thereof, * * * a royalty of 12-1/2 percent [4/] of the value or amount of

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4/ The Solicitor has furnished us with copies of leases Nos. 9 and 455, which are apparently the oldest and newest leases in question here. Lease No. 455 specifies a royalty rate of 16-2/3 percent. By quoting the regulations and lease terms, we make no comment as to what specific royalty rate may be applicable in any of the leases here.

all oil, gas, and/or natural gasoline, and/or all other hydrocarbon substances produced and saved from the land leased, save and except oil, and/or gas used by the lessee for development and operation purposes on the lease, which oil or gas shall be royalty free. * * * During the period of supervision, "value" for the purposes of the lease may, in the discretion of the Secretary of the Interior, be calculated on the basis of the highest price paid or offered (whether calculated on the basis of short or actual volume) at the time of production for the major portion of * * * gas, and/or natural gasoline, and/or all other hydrocarbon substances produced and sold from the field where the leased lands are situated, and the actual volume of the marketable product less the content of foreign substances as determined by the supervisor. The actual amount realized by the lessee from the sale of said products may, in the discretion of the Secretary of the Interior, be deemed mere evidence of or conclusive evidence of such value. * * * In determining the value for royalty purposes of products, such as natural gasoline, that are derived from treatment of gas, a reasonable allowance for the cost of manufacture shall be made, such allowance to be two-thirds of the value of the marketable product unless otherwise determined by the Secretary of the Interior on application of the lessee or on his own initiative, and that royalty will be computed on the value of gas or casing-head gas, or on the products thereof (such as residue gas, natural gasoline, propane, butane, etc.), whichever is the greater.

Sections 3(c) and (d) of the tribal lease terms also expressly address this question:

(c) Rental and royalty. -- To pay * * * a royalty of 12-1/2 percent [5/] of the value or amount of all oil, gas, and/or natural gasoline, and/or all other hydrocarbon substances produced and saved from the land leased herein, save and except oil, and/or gas used by the lessee for development and operation purposes on said lease, which oil or gas shall be royalty free. During the period of supervision, "value" for the purposes hereof may, in the discretion of the Secretary, be calculated on the basis of the highest price paid or offered (whether calculated on the basis of short or actual volume) at the time of production for the major portion of the oil of the same gravity, and gas, and/or natural gasoline, and/or all other hydrocarbon substances produced and sold from the field where the leased lands are situated, and the actual volume

5/ See n.4, supra.

> of the marketable product less the content of foreign substances as determined by the oil and gas supervisor. The actual amount realized by the lessee from the sale of said products may, in the discretion of the Secretary, be deemed mere evidence of or conclusive evidence of such value. * * * It is understood that in determining the value for royalty purposes of products, such as natural gasoline, that are derived from treatment of gas, a reasonable allowance for the cost of manufacture shall be made, such allowance to be two-thirds of the value of the marketable product unless otherwise determined by the Secretary of the Interior on application of the lessee or on his own initiative, and that royalty will be computed on the value of gas or casinghead gas, or on the products thereof (such as residue gas, natural gasoline, propane butane, etc.), whichever is the greater.
>
> (d) Monthly statements. -- To furnish to the oil and gas supervisor monthly statements in detail in such form as may be prescribed by the Secretary of the Interior, showing the amount, quality, and value of all oil, gas, natural gasoline, or other hydrocarbon substances produced and saved during the preceding calendar month as a basis upon which to compute, for the treasurer of said tribe or the superintendent, the royalty due the lessor. The leased premises and all wells, producing operations, improvements, machinery, and fixtures thereon and connected therewith and all books and accounts of the lessee shall be open at all times for the inspection of any duly authorized representative of the Secretary of the Interior.

Under these provisions, the Area Supervisor is given considerable latitude in determining what is the "value" of the production from a lease. Amoco Production Co., 29 IBLA 234, 236 (1977). He may simply adopt as conclusive the actual amount which a lessee receives from sales of the leased product as its "value," or may, in his discretion, go so far as to take the highest price paid or offered for the major portion of the gas produced and sold from the field where the leased lands are located as "value" -- a figure which might be substantially higher than the actual sale price.

Under the regulations applying generally to all oil and gas leases controlled by the United States, the Area Supervisor may impose the value of production for computing royalty in which he determines is "reasonable," duly considering the highest price paid for a part or majority of production of like quality in the same field. 30 CFR 221.47.

[2] Nevertheless, it must appear on review that there is a reasonable basis in fact for his decision to set value other than at the

actual price received. In the instant case, the Area Supervisor assembled complete sales data from all Jicarilla tribal leases for the years 1971 through 1973. He then determined the median price for all gas sold from these leases in each calendar year, that is, the price at which, or above which, half of the gas was sold and, at the same time, the price at which, or below which, the other half was sold. For example, in 1971, 49,282,772 mcf of gas were sold from all of the Jicarilla leases. The median price from these sales was $0.15, meaning that 24,641,386 mcf were sold at this price or higher, and 24,641,386 mcf were sold at this price or lower. Thus, the figures adopted by the Area Supervisor are based on actual production figures. The Area Supervisor adopted these median prices as the floor values of gas for each year, that is, he held that the "value" of the gas throughout each year was <u>not less than</u> these median values.

The use of the yearly median in this manner as the floor value for that year is within the discretionary latitude granted to the supervisor by the regulations. The median is not necessarily the "highest price paid or offered for the major portion of" the gas. For example, it is possible that the prices <u>offered</u> for the gas were higher than the actual prices paid for it. However, it should be remembered that the figures adopted by the supervisor are not replacements for the actual sales prices, but are floors beneath which these values may not be calculated. Thus, the lessees must still report and use the actual prices if they are above these floors and may well pay royalty based on a value higher than the sale price actually received. Sales prices may not always reflect true value. Therefore, it is not unreasonable to impose a floor value which is less than the highest value which the regulations would permit.

The Area Supervisor was justified in demanding that value be reported as the monthly proceeds from sales where these proceeds are <u>greater</u> than the specified minimum floor price. Under 30 CFR 221.47, the value of production for royalty purposes must be at least <u>equal</u> to the actual proceeds accruing to the lessee upon sale of the output of the lease. <u>Amoco Production Co.</u>, <u>supra</u> at 236; <u>Wheless Drilling Co.</u>, 13 IBLA 21, 80 I.D. 559 (1973); <u>see</u> <u>California Co.</u> v. <u>Udall</u>, 296 F.2d 384 (D.C. Cir. 1961). This would not be so if the minimum floor price were accepted when actual sales proceeds were higher.

[3] By establishing floor values based on actual sales data of similar products, the Department prevents a lessee from avoiding its obligation to pay a fair royalty to the owners of the leased resources. It is irrelevant that the sales prices which fall below these floor values are set by long-term contract. The lessee may not avoid its responsibility to pay a fair royalty because it has made long-term commitments. The regulations clearly allow the superimposition of the Area Supervisor's determination of values based on actual market conditions on any sales prices which fall below this standard and make no provisions for exempting production from leases which is subject to pre-existing long-term pricing.

[4] Lessees each contend that the Department, by accepting their monthly reports which state that the value was the actual sales price, and has exercised its discretion and elected to consider these prices as conclusive evidence of such value, so that it may not change the value on which royalty is computed. This argument is not persuasive.

In 1958 GS adopted the practice of billing lessees for royalty on the basis of the information contained in monthly reports which they submitted, subject to post audit. Big Piney Oil and Gas Co., A-29895 (July 27, 1964). According to the affidavit of the Chief Accountant, Conservation Division, GS, this procedure is still in effect today and was at all times in question: The statements of account (bills) generally reflected only the information on value supplied by the lessees, except for automatic rental or minimum royalty charges, and correction of obvious errors. The statements contained no independent verification by GS personnel as to value of the production of the lease (Sol. Brief, Exh. A).

In the absence of acceptance of the lessee's statement of value as conclusive by any official authorized to bind the Department contractually, the Department is not barred from rejecting this statement as incorrect, determining value by another acceptable method, and demanding payment of royalty based on this method. Big Piney Oil and Gas Co., supra. Otherwise, there must be an express commitment to accept a certain amount of royalty, and an Area Supervisor's silence on the question of how much royalty is due implies no such commitment. Sinclair Oil and Gas Co., 75 I.D. 155, 172-3 (1968).

The monthly statements do not indicate or suggest that the amounts charged therein are final determinations of the royalty due. Appellants have shown nothing to indicate that the Department explicitly indicated that these statements would finally establish value. Therefore, we find that the Department's first explicit action to determine value officially was taken when the Area Supervisor issued the orders here. No election by the Department to accept the actual sales prices as representative of true value occurred previously. 6/

Nor does the delay in taking this first action affect its validity. The authority of the United States to protect a public interest,

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6/ We do not imply that such explicit approval of royalty payment would necessarily bind the Government in all cases. Where the Department directs lessees (even explicitly) to compute royalty in a manner which is beyond its authority to allow, it is not estopped by its acceptance of the erroneous payments from correcting its error. Atlantic Richfield Co. v. Hickel, 432 F.2d 587, 591 (10th Cir. 1979). In the instant case, we do not imply that royalties may not be increased further if it is finally determined judicially that the Department was without authority to compute value in this manner.

including its obligation to protect the ownership rights of the Jicarilla Apaches, is not vitiated or lost by its employees' laches, failure to act, or delays in the performance of their duties. 43 CFR 1810.3(a). Lessees could not properly have relied on the Area Supervisor's failure to act. Sinclair Oil and Gas Co., supra.

Our holding is in conformity with the realities of administering the collection of lease royalties. When GS receives a lessee's monthly statement of value, it cannot immediately know what the sales data for the entire field are, and it will necessarily take time to assemble this information and interpret it. Inaction during this time could reasonably indicate that the Department is considering whether to adopt these sales prices as adequate for "value" or, instead, to impose its own determination thereof on the lessee.

Lessees cite Continental Oil Co. v. United States, 184 F.2d 802, 821 (9th Cir. 1950) for the proposition that the Department may not reassess royalty at a value in excess of that previously determined and billed by the Department. In Continental, the Department issued an order on June 4, 1931, which recited that the value of gas produced from leases in California would be $0.05 per mcf and that the value of natural gasoline would be $0.06 below the San Francisco price for tank-wagon lots, or alternatively would be the amounts actually received by the lessees, if greater than the former amounts. This order was changed on June 23, 1931, to tie the floor value of gasoline to the retail market, but no change in the fixed minimum value of gas was ordered. United States v. General Petroleum Corp., 75 F. Supp. 225, 232 (S.D. Cal. 1946), aff'd, Continental Oil Co. v. United States, supra. On June 7, 1937, more than 6 years after making this official announcement on how the values of lease products would be determined, the Department issued another order again altering this policy to introduce the "net-realization" method of accounting as an alternative to the "actual-price-above-specified-minimum" method in effect since 1931. Ibid.

Before the Ninth Circuit, the Department argued that it could not only apply the 1937 method to collect royalties on production realized after the effective date of the ordering establishing it, but could also use it to recompute royalties from production realized before this date where the lessee had not yet paid them. In the section cited by lessees, the Ninth Circuit held that the method adopted in 1937 could be applied prospectively only and not to production between 1931 and its issuance.

In Continental, the Department had expressly elected a method of valuation of lease products in June 1931 and had officially ordered lessees to adopt it. The instant case is materially different, in that, as noted above, the Department made no such election until 1976 and 1977. Unlike in Continental, where the Department was attempting to reassess value retroactively, the Department made its initial assessment of value here, although it was made after the sales in question. The Ninth Circuit's rule in Continental is consistent with that in Big Piney, supra: Where the Department has not specified that a particular method of valuation adopted by a lessee is adequate, it may assert that the method is incorrect and redetermine royalty after the sales, even though payment has already been accepted (Big Piney); where the Department has specified that a method of valuation is adequate, it may not assert that this method is incorrect or incomplete and reassess value retroactively in order to raise the royalty due, even though payments have not been tendered (Continental).

Thus, Continental does not support lessees' position. To the contrary, it stresses that the issuance and communication of a Departmental policy decision regarding how value is to be determined will settle the question for all production until the decision is superseded by another determination. Thus, the policy announced in 1958 and enforced by the Department in Big Piney, supra (under which the Department bills lessees for royalty on the basis of information submitted by them, reserving the right later to reject the billed amounts as incorrect, in the absence of express acceptance of this amount), still stands, as lessees make no suggestion that it was superseded by any other Departmental policy statement.

We also reject lessees' argument that the Area Supervisor's orders are not final in that they set a minimum value for royalty but fail to set a maximum, and so avoid the final determination of value and leave the way open for further determinations. This is simply not true. The import of the orders is that the amount on which royalty must be determined is either the price specified in the order for a particular year, or the price at which the gas was actually sold, whichever is greater. There is no uncertainty or lack of finality in this, as both price figures are known. The orders might well have been phrased in a way which would have made this result clearer, but it is difficult to believe that lessees retain any bona fide doubt as to what the directive means at this stage of the proceeding. 7/

Atlantic Richfield Co. (Arco), Continental Oil Co., and Tenneco Oil Co., argue that the Area Supervisor erred by considering all gas sales from the reservation, including both intrastate sales and interstate sales under regulated prices. They note the price at which the major portion of gas sold would be lower than he found if he had considered only the intrastate market, which they feel is a more competitive, and therefore more representative, marketplace. The regulations

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7/ As noted above at n.6, in holding that these orders were final, we simply hold that they required definite action by lessees which was not subject to later revision. We do not imply that lessees will not be subject to judicial or administrative orders increasing the valuation of the products in question in the event that it is determined that these orders were inadequate to establish value correctly.

and lease terms allow the Area Supervisor to consider the actual prices of the gas, etc., sold from the entire field, without regard to the type of market in which the products are sold. Thus, as we have held above, the Area Supervisor was within his discretion in basing his determination of value on all sales from Jicarilla leases. This information necessarily concerned sales in both the inter- and intrastate markets and was therefore representative of the actual proceeds received by lessees, who admittedly sold the gas in both markets. Moreover, the Area Supervisor has the authority to use the highest price paid as his guide. Thus, he was within his authority in declining to use the intrastate price, as it was admittedly not the highest pricing guide available.

The case cited in Arco's brief in support of this argument, Hemus v. Hawkins, 452 F. Supp. 861 (S. D. Texas 1978), is not in point. This matter was a suit to enforce a private royalty arrangement under which royalty was computed on the "market value" of the lease product and so does not relate to the terms under which Federal royalties are determined. In any event, the holding there that intrastate prices should be used in computing the "market value" was based on the fact that all of the production in question was sold intrastate. Such is not the case here.

Exxon Co., U.S.A. (Exxon), has challenged the propriety of ordering it to amend its royalty payments, stating that it has only a nonoperating interest and that Supron had agreed to perform its obligations to pay royalty. It is inappropriate to consider what the arrangement between Exxon and Supron may have been regarding Supron's assuming the responsibility of paying royalty due under Exxon's share of the leases. As Exxon admits, it was the lessee of record during the time in question. As such, it is responsible for payment of the correct royalty due, and the Area Supervisor was without fault in informing it of this responsibility.

[5] Up to this point, this opinion has considered only one method of determining the value of production from a lease, that is, the method where the actual sales price of the product, not less than specified floor prices, determines its value. There are two other means of determining value in question: the "BTU" and "net-realization" methods. In the former, the volume of the crude gas stream is measured at the wellhead (after casinghead gasoline is removed) and the BTU value of the gas stream is periodically measured. Then, the volume is multiplied times the price of gas per mcf, which result is in turn multiplied by an adjustment factor to account for its BTU content, giving the value under the BTU method. In the "net-realization" method, the values of the component parts of the gas stream (gasoline, propane, butane, ethane, etc., and the residue gas remaining after these products are removed) are determined after they have been separated from the gas stream by processing. The aggregate of the values of these component parts is determined and an allowance

for the cost of manufacturing (separating) the component parts is subtracted from it. The difference is regarded as the value under the net-realization method, being the net value of the products realized from the crude gas stream.

Supron has appealed from the Area Supervisor's order of December 10, 1976, which requires it to make reports of value for 1974 through 1976 by both the BTU and net-realization methods and submit royalty based on the method yielding the higher value. Although it is not clear in this order, we presume that the Area Supervisor was also directing Supron to compare the values resulting from these two methods with the actual price received for the gas, and to pay method royalty based on the highest of these three figures. (N.B. that it appears that no minimum floor value has been set for 1974 through 1976.) Additionally, the Area Supervisor directed Supron to use specific cost-of-manufacture allowances for these years. Supron has challenged the authority of the Area Supervisor to direct it to use these methods and the validity of these specified yearly cost-of-manufacture allowances.

There is no question that the Area Supervisor had the authority to require Supron to compute value under the BTU and net-realization methods, and to require it to submit the highest royalty determined from these methods or from actual prices. The provisions of 30 CFR 221.47 clearly justify the BTU method, providing that the value of production for computing royalty shall in no circumstances be deemed to be less than the value computed on such reasonable unit value as the Area Supervisor determines on behalf of the Secretary. Similarly, section 3(c) of the leases notes that royalty will be computed on the value of gas. The BTU method measures the value of gas by effectively applying the price rate per BTU and so directly follows these provisions.

Use of the net-realization method is also clearly authorized. Section 3(c) of the leases notes expressly that royalty may be computed on the value of products of gas such as natural gasoline, propane, butane, and residue gas, and that the royalty due shall be the greater of the two amounts determined by this and the value-of-gas (BTU) methods. The provisions of 30 CFR 221.50 implicitly justify using the net-realization method as well, in that they refer to determining royalty on the basis of the value of dry gas remaining after the extraction of gasoline (30 CFR 221.50(a)) and to the aggregate value of all commodities obtained from the product (30 CFR 221.50(c)). Section 3(c) of the leases and 25 CFR 171.13(a) both specify a discretionary two-thirds cost-of-manufacture allowance to be used in determining the aggregate value of component parts derived from treatment of the product.

Thus, computation of royalty by the higher of the two values determined by the BTU and net-realization methods is well recognized in the regulations and lease terms. Accordingly, we conclude that it was proper for the Area Supervisor to require Supron to do so.

[6] Even were we to disregard the presence of this authorization to use this dual accounting method, we would be constrained to affirm the Area Supervisor's decision in view of the interim holding of the United States District Court for the District of New Mexico in The Jicarilla Apache Tribe v. Supron Energy Corp., et al., No. 75-247-M (November 5, 1979), which inter alia, orders Supron to utilize the dual accounting system. Inasmuch as this action addresses this issue directly, and as Supron and the Department are both parties to it, the question of the imposition of the dual accounting requirement is apparently res judicata, the only question remaining being whether the opinion cited is the final order of the District Court for the District of New Mexico.

It remains to decide whether the Area Supervisor's decision imposing a specific cost-of-manufacture allowance for 1974 through 1976 was correct. The regulations, 25 CFR 171.13(a), and the lease terms, section 3(c), authorize the Area Supervisor, as the Secretary's representative (see 30 CFR 221.2(c) and 221.3), to grant two-thirds of the value of the marketable component parts of the gas as a cost-of-manufacture allowance, to be deducted from the receipts from the sales of these component parts to give the aggregate value for royalty purposes. However, he is also granted the discretion to determine otherwise if appropriate. Thus, even though as Supron alleges, the two-thirds allowance may be standard in the oil and gas industry, the Area Supervisor clearly has the authority to establish a different allowance if he has a reasonable basis for doing so.

On his review of these matters, the Deputy Commissioner was not satisfied that the record showed that the allowance which the Area Supervisor established was correct and accordingly remanded the case to him for explanation of the basis of this decision. The Area Supervisor responded immediately by writing directly to Supron with data supporting his conclusion as to the specific cost-of-manufacture allowance for 1974 and 1975, but he did not address the quoted figure for 1976. No copy of this material was placed in the administrative record by the Supervisor, but Supron has included the original letter as Exhibit D to its statement of reasons.

We are satisfied that the Area Supervisor's decision to establish specific allowances for 1974 and 1975 is well based in fact, and we conclude that it is accurate. On April 15, 1976, the Area Supervisor notified Supron that he was required to monitor accounting on both the BTU and the net-realization methods, and that he would be redetermining the cost-of-manufacture allowance used in the latter method. Accordingly, he requested that Supron provide him with specific data and enclosed a copy of the guidelines to be used for doing so.

In his letter to Supron, pursuant to the Deputy Commissioner's decision, the Area Supervisor explained that he used this data in determining the specific allowances for 1974 and 1975 and showed exactly how he did so. In the absence of a clear demonstration that this methodology was incorrect, it is entitled to our deference, as the Area Supervisor has been duly delegated the authority to make this determination and is well familiar with the particulars of oil and gas production. See Rosita Trujillo, 21 IBLA 289, 191 (1975).

In any event, we are satisfied that it is an accurate and liberal method of determining the cost-of-manufacture allowance. It takes into account production and maintenance expenses, depreciation, and grants an additional 10 percent allowance for administrative and general expenses. The result is a figure representing the cost of manufacturing each gallon of liquid product separated in the Lybrook Plant, which, at the time in question, was owned by Supron.

The Lybrook Plant apparently processed gas from many different sources, and the Area Supervisor's allowance is based on all processing done at this facility. Supron objects to the Area Supervisor's failure to identify specifically the cost of manufacture of the gas from the Jicarilla tribal leases. In the absence of a clear showing by Supron to the contrary, a plant-wide average is a reasonable means of determining the cost of processing a gallon of by product from the gas streams of the Jicarilla leases, and we accept it as valid. Id.

Supron also challenges the Area Supervisor's failure to give it credit for expenses incurred for State and Federal income taxes and for fuel costs or shrinkage, and proper credit for administrative and general expenses.

Inasmuch as it is determined by numerous factors, many of which are unrelated to operation, including income and/or losses from other sources, tax brackets, accounting methods, etc., income tax is not properly regarded as a cost-of-manufacture which may be deducted from gross receipts in order to determine the value of a product. It is proper to apply Federal income taxation principles to royalty determination questions. See Amoco Production Co., supra at 237, n.1. Income taxes are imposed upon realized gain, not upon realized gain diminished by the amount of such taxes which ultimately may be found attributable to the realized gain. Taylor v. Commissioner of Internal Revenue, 298 F.2d 198, 203 (4th Cir. 1962). So it is also with the imposition of royalty.

In fact, fuel costs and shrinkage are taken into account in the dual-accounting system. Royalty is determined on the basis of the volumes of products leaving the processing plant. These volumes are clearly diminished when gas is lost in transit to the plant or is used in processing. That is, if gas is lost in transit and/or consumed during processing, the amount of royalty will be reduced accordingly because the amount of product sold at the tailgate of the plant will be reduced by an equivalent amount. Thus, the net-realization system automatically takes into account these factors. Of course, if an excessive amount of gas is lost and/or used for production, the lessee will not avoid paying royalty, as it will be charged alternatively on the basis of the actual-sales-price or wellhead volume (BTU) methods described above if they show a greater value.

Part 6477.3 E(9) of the GS Conservation Division Manual specifies a maximum allowance of 10 percent of the permittee's operating and maintenance costs for general administrative costs such as telephone service, office supplies, etc. While this manual does not have the force of law, we will not disturb a decision based on it in the absence figures clearly showing that 10 percent of total expenses is inadequate as a credit for administrative and general expenses.

The part of this decision which requires Supron to calculate value under the BTU and net-realization methods and submit appropriate royalty payments for 1974 and 1975 is affirmed, and Supron is ordered to comply within 60 days of its receipt of this decision. However, the Area Supervisor's explanation of the methodology used in arriving at the cost-of-manufacture allowances does not address how he determined this value for the year 1976. It is necessary that he do so before Supron is ordered to comply with his December 10, 1976, decision. Accordingly, the matter is remanded to the Area Supervisor so that he may offer the same type of explanation concerning the specified cost-of-manufacture allowance for 1976 as he presented for 1974 and 1975.

The Area Supervisor's decisions requiring all lessees to adopt minimum floor prices and recompute royalties as required for the years 1971 through 1973, and the Deputy Commissioner's decision affirming them, are also affirmed, and lessees are ordered to comply within 60 days from their receipt of this decision.

Therefore, pursuant to the authority delegated to the Board of Land Appeals by the Secretary of the Interior, 43 CFR 4.1, the decision appealed from is affirmed in part and remanded in part for clarification.

Edward W. Stuebing
Administrative Judge

We concur:

Frederick Fishman
Administrative Judge

James L. Burski
Administrative Judge

APPENDIX

IBLA NO.	LESSEES/ APPELLANTS*	DEPUTY COMMISSIONER'S DECISION NO. (DOCKET NO.)	DATE	DATES OF AREA SUPERVISOR'S ORDER(S)
79-374	Supron Energy Corp. *	IND-10-O&G (IND 9)	1-16-79	12-10-76 12-13-76
79-390	Atlantic Richfield Co.	IND-13-O&G (IND 12)	3-8-79	3-18-77
	Continental Oil Co.	IND-15-O&G (IND 14)	3-8-79	12-10-76
	Tenneco Oil Co.	IND-15-O&G (IND 10)	3-8-79	12-14-76
79-420	Exxon Co., U.S.A.	IND-16-O&G (IND 13)	3-8-79	3-18-77
79-421	Southland Royalty Co.*	IND-9-O&G (IND 2)	12-20-78	12-9-76
79-427	Consolidated Oil and Gas Co.	IND-14-O&G (IND 3)	3-8-79	12-10-76

* These names are the lessees' current names. Supron Energy Corp. was formerly Southern Union Production Co.; Southland Royalty Co. was formerly Aztec Oil and Gas Co.